

General Information Letter: Petition to use separate accounting cannot be granted without showing that the statutory apportionment formula fails to fairly represent the extent of the taxpayer's business activity in Illinois.

March 23, 2000

Dear:

This is in response to your letter postmarked March 13, 2000, in which you request permission for xxxxxxxxxxxxxxxxxxxxxxxxx to use separate accounting rather than the statutorily-mandated apportionment formula, pursuant to Section 304(f) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 101 et seq.). The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www.revenue.state.il.us](http://www.revenue.state.il.us). For the reasons discussed below, your petition cannot be granted at this time.

In your letter you have stated the following:

BACKGROUND: xxxxxxxxxxxxxxxxxxxxxxxxx, FEIN xxxxxxxxxx has been operating in xxxxxxxxxxxx, Illinois since 1993. xxxxxxxxxxxx xxxxxxxxxxxx is a Sub-Chapter S Corporation whose sole business and sole asset is the ownership and operation of a residential apartment complex of 72 units. Separate books and records for this corporation have always been kept. Tax returns for xxxxxxxxxxxxxxxxxxxxxxxxx filed since 1993 have reflected this separate accounting.

For tax year 1999, in accordance with IRS notice 97-4, the stock of xxxxxxxxxxxxxxxxxxxxxxxxx was acquired by xxxxxxxxxxxxxxxxxxxxxxxxx, a Sub-Chapter S corporation, as the parent company. From a Federal tax standpoint, xxxxxxxxxxxxxxxxxxxxxxxxx was dissolved and became a Qualified Sub-Chapter S Subsidiary (QSSS) of xxxxxxxxxxxxxxxxxxxxxxxxx, xxx. For Federal tax purposes, xxxxxxxxxxxxxxxxxxxxxxxxx income and expenses are now reflected on xxxxxxxxxxxxxxxxxxxxxxxxx tax return.

xxxxxxxxxxxxxxxxxxxxxx was a newly formed Sub-Chapter S Corporation for tax year 1999. It has no operations itself but is merely a parent company formed to acquire the stock of xxxxxxxxxxxx xxxxxxxxxxxx and eight other Sub-Chapter S corporations as QSSSs. xxxxxxxxxxxxxxxxxxxxxxxxx is 100% owned by xxxxxxxxxxxxxxxxxxxxxxxxx, as were the eight acquired Sub-Chapter S Corporations. The eight other corporations all have separate accounting and retain their legal status.

The eight other operations consist of the following:

1. A mortgage banking company in xxxxxxxx.
2. A nursing home in xxxxxxxx.
3. An apartment complex in xxxxxxxx.
4. A second apartment complex in xxxxxxxx.
6. An assisted-living facility in xxxxxxxx.
7. An apartment complex in xxxxxxxx.
8. An apartment complex in xxxxxxxxxxxx.

Because of the diversity of the different business activities and the wide separation in locations, the application of the apportionment

provisions of IITA Section 304(a) through (e) to xxxxxxxxxxxxxxxxxxxxxxxx  
xxxx do not fairly represent the extent of the business activity in  
Illinois. The application of the statutory formula will lead to a  
grossly distorted result in this case.

REQUEST: This is a request to allow xxxxxxxxxxxxxxxxxxxxxxxx for  
1999 and all subsequent tax years to use the income and expense  
numbers from the separate accounting records kept for the operation  
in Illinois formerly filed under xxxxxxxxxxxxxxxxxxxxxxxx.

Use of the separately maintained actual accounting numbers for the  
Illinois operation prevents any distortion of the Illinois operating  
results and accurately and fairly treats the State and the taxpayer.

### **Response**

Illinois income tax regulation 86 Ill. Adm. Code Section 100.3010(b) provides:

Two or more businesses of a single person.

- 1) A person may have more than one "trade or business". In such cases, it is necessary to determine the business income attributable to each separate trade or business. In the case of a person other than a resident, the income of each business is then apportioned by a formula which takes into consideration the instate and outstate factors which relate to the trade or business the income of which is being apportioned.
- 2) Example: The person is a corporation with three operating divisions. One division is engaged in manufacturing aerospace items for the federal government. Another division is engaged in growing tobacco products. The third division produces and distributes motion pictures for theaters and television. Each division operates independently; there is no strong central management. Each division operates in this state as well as in other states. In this case, it is fair to conclude that the corporation is engaged in three separate "trades or businesses". Accordingly, the amount of business income attributable to the corporation's trade or business activities in this state is determined by applying an apportionment formula to the business income of each business.
- 3) The determination of whether the activities of the person constitute a single trade or business or more than one trade or business will turn on the facts in each case. In general, the activities of the person will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon, or contribute to each other and the operations of the person as a whole. The following factors are considered to be good indicia of a single trade or business, and the presence of any one of these factors creates a strong indication that the activities of the person constitute a single trade or business.
  - A) Same type of business. A person is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a person which

operates a chain of retail grocery stores will almost always be engaged in a single trade or business.

- B) Steps in a vertical process. A person is almost always engaged in a single trade or business when its various divisions or segments are engaged in a vertically structured enterprise. For example, a person which explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the person's executive offices.
- C) Strong centralized management. A person which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing. Thus, some corporations may properly be considered as engaged in only one trade or business when the central executive officers are normally involved in the operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing. Note in this connection that neither the existence of central management authority, nor the exercise of that authority over any particular function (through centralized departments or offices), is determinative in itself; the entire operations of the person must be examined in order to determine whether or not strong centralized management absent other unitary indicia as described above (i.e., same type of business or steps in a vertical process) justifies a conclusion that the activities of the person constitute a single trade or business. Both elements of strong centralized management, i.e., strong central management authority and the exercise of that authority through centralized departments or offices, must exist in order to justify a conclusion that the operations of seemingly separate divisions are significantly integrated so as to constitute a single trade or business.

Your letter does not address the issue of whether or not the business of xxxx  
xxxxxxxxxxxxxxxxxxxx and the businesses of the other Subchapter S corporations  
actually constitute a single unitary business. If the business of xxxxxxxxxxxx  
xxxxxxxxxxxx is in fact separate from the other businesses, then Section  
100.3010(b) requires xxxxxxxxxxxxxxxxxxxxxxxxx to apportion the business income  
of xxxxxxxxxxxxxxxxxxxxxxxxx using according to the apportionment factors of that  
subsidiary only. This will likely produce either the result you are seeking in  
your petition or a result that you will not consider to be grossly distorted.

If, on the other hand, the business of xxxxxxxxxxxxxxxxxxxxxxxxxx is unitary with the other subsidiaries' businesses, you have not presented evidence sufficient to allow us to grant your request.

Section 304(f) of the IITA provides:

If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable:

- (1) Separate accounting;
- (2) The exclusion of any one or more factors;
- (3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

Taxpayers who wish to use an alternative method of apportionment under this provision are required to file a petition complying with the requirements of 86 Ill. Adm. Code Section 100.3390, which may be found on the Department's web site at [www.revenue.state.il.us](http://www.revenue.state.il.us). Section 100.3390(c) provides:

A departure from the required apportionment method is allowed only where such methods do not accurately and fairly reflect business activity in Illinois. An alternative apportionment method may not be invoked, either by the Director or by a taxpayer, merely because it reaches a different apportionment percentage than the required statutory formula. However, if the application of the statutory formula will lead to a grossly distorted result in a particular case, a fair and accurate alternative method is appropriate. The party (the Director or the taxpayer) seeking to utilize an alternative apportionment method has the burden of going forward with the evidence and proving by clear and cogent evidence that the statutory formula results in the taxation of extraterritorial values and operates unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in this State. In addition, the party seeking to use an alternative apportionment formula must go forward with the evidence and prove that the proposed alternative apportionment method fairly and accurately apportions income to Illinois based upon business activity in this State.

Your request contains no evidence showing that, assuming a unitary business does exist, the statutory apportionment formula will lead to a grossly distorted result or that the separate accounting you request will fairly and accurately apportion the unitary business income of xxxxxxxxxxxxxxxxxxxxxxxxxx to Illinois. Accordingly, we are unable to grant your request at this time.

Please note that 86 Ill. Adm. Code Section 100.3390(e)(1) requires a petition to be filed at least 120 days prior to the due date (including extensions) for the first return for which permission is sought to use the alternative apportionment

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method. A petition filed March 13, 2000 will allow a taxpayer to use the requested method on original returns due on or after July 11, 2000, if granted.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you still believe that your petition should be granted, please supplement the petition in accordance with the provisions of 86 Ill. Adm. Code Section 100.3390. If you have any questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton  
Deputy Chief Counsel -- Income Tax